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STATE FOR WHA/CAR (WBENT), WHA/EPSC (JSLATTERY),
EB/IFD/OMA (JUNCKER)

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TREASURY FOR L LAMONICA

SENSITIVE

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E.O. 12958: NA
TAGS: ECON EFIN JM
SUBJECT: JAMAICAN ECONOMY SHOWING SIGNS OF RECOVERY

Ref: 05 KINGSTON 02797

¶1. (SBU) Summary: Signs of recovery have started to emerge in the Jamaican economy following the devastation caused by Hurricane Ivan in 2004. Real GDP rose by 2.9 percent during the period from July to September 2005, reflecting robust growth in the productive sectors. Declining oil prices and a recovery in agricultural production also tempered inflation during this quarter of ¶2005. On January 18, Standard and Poor's Rating Services (S&P) affirmed its 'B' long and short-term sovereign credit ratings for Jamaica in response to the general economic improvement. Nevertheless, fiscal challenges remain, with the Ministry of Finance formally abandoning its balanced budget target (reftel) for 2006. While macro-economic performance is expected to continue to improve in 2006, difficulties could emerge on the fiscal front when the public sector wage freeze ends in March. End summary.

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Hard Data Heartening, Considering Externalities
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¶2. (U) Data released by the Statistical Institute of Jamaica on January 17 showed that the Jamaican economy grew by 2.9 percent during July to September 2005, bringing GDP growth for the nine-month period to 1.1 percent. The improved third quarter result was largely due to a 5.7 percent jump in goods production, signaling a normalization of output following the impact of Hurricane Ivan in 2004. Mining activity rebounded by 15.8 percent following the battering from Ivan. Construction (up 8.2 percent) and water and electricity (up 10.2 percent) surged forward due to continued rehabilitation efforts as well as increased road construction. Agriculture recorded growth of 1.3 percent despite the subsequent onslaught of Hurricanes Dennis and Emily in 2005 and prolonged rain, while manufacturing (up 1.9 percent) improved following the resumption of normal production at the national oil refinery.

¶3. (U) Stability in international oil prices and the partial recovery in agriculture combined to temper inflation during the last quarter of 2005. Inflation for the period rose by one percent, well below the 4.3 percent recorded in the September quarter and brought inflation for 2005 to 12.9 percent or 0.8 percentage points below the previous year. While this result was well above the

GOJ's revised target of 9.0 percent, it represents the first slowing in annual inflation since the country reverted to double-digit inflation in 2003. Inflation for the fiscal year to December 2005 stood at 11.3 percent.

International Markets Still Optimistic.

¶4. (SBU) On January 18, Standard and Poor's Rating Services affirmed its 'B' long and short-term sovereign credit ratings on Jamaica. The ratings agency attributed its stable outlook to the GOJ's ongoing commitment to fiscal discipline and debt reduction amid external shocks and higher growth prospects. According to S&P credit analyst Olga Kalinina, "the confidence level of domestic businesses and international investors remains strong, reflecting the government's timely and appropriate policy response to adverse external developments." However, the agency highlighted the difficulties government faces in generating its programmed fiscal surpluses in 2006 and beyond. S&P said GOJ operations are now expected to generate a fiscal deficit of 1.6 and 1.5 percent of GDP in 2006 and 2007, respectively. The ratings agency said that despite the worse-than-expected deficit, the debt to GDP ratio is expected to decline from 133 to 127 percent. S&P said "the stable outlook balances the expectation of prudent fiscal policies and promising growth prospects with significant risk stemming from the high interest and foreign exchange rate-sensitive government debt and rising fiscal pressures." The agency also insinuated that if the GOJ misses its 2007 fiscal target, S&P would be forced to lower the country's credit rating.

.Despite Missed Targets

¶5. (SBU) The GOJ formally announced the abandonment of its balanced budget target at a Bear Stearns investment conference on January 16, in Miami. At the conference, new Financial Secretary Colin Bullock advised that the Ministry of Finance had revised its fiscal deficit projection to two percent of GDP for 2005/06 and one percent for 2006/07 (reftel). Bullock also suggested that the achievement of a balanced budget target would be delayed until 2007/08. The postponement is not surprising given that the public sector wage restraint comes to an end in March 2006 and public sector workers who have been under a wage freeze for the last two years will make every effort to recover their lost purchasing power. Some trade unions have already suggested that their wage increase demand could be as high as 50 percent. The decision to delay the balanced budget target could also have been influenced by the fact that the next fiscal year could be an election year and the GOJ is allowing some flexibility for additional spending on capital projects during the year.

¶6. (SBU) GOJ plans to increase expenditures in line with the pre-2002 election level could be moderated by the presence of Bullock, who has established himself as a hardnosed technocrat at the Bank of Jamaica. On the other hand, Bullock has never had to report directly to a political master, and this may temper his rigidity on fiscal issues. In fact, a Ministry of Finance source told emboff that the postponement of the balanced budget until after the election was a clear indication that room was being made for some amount of fiscal imprudence. If true, such indiscipline could be moderated by increasing surveillance from the capital market, with any major deviation from target expected to result in a loss of confidence.

Comment

¶7. (SBU) Barring unforeseen shocks, the Jamaican economy should achieve growth of 2.5 percent in 2006, up from the estimated 1.5 percent in 2005. This output expansion is predicated on continued growth in construction, tourism, electricity and mining. Data from the Jamaica Tourist Board shows that stopover arrivals jumped by 14.3 percent between September and November 2005 and preliminary information suggest that the momentum has continued into the winter tourist season, with most hoteliers reporting full occupancy. The increased stopover arrivals have allowed hoteliers to revert to market prices for the first time since the September 2001 terrorist attacks in the United States. With agriculture expected to recover fully in 2006 and with oil prices stabilizing, inflation is predicted to moderate in 2006.

¶8. (SBU) Comment (cont'd): The impending end of the wage restraint with public sector workers is threatening to unravel all the gains made during the last year and a half, with trade unions agitating for a sizeable wage correction. However, while public sector workers will require an adjustment to recover lost purchasing power, trade union leaders are cognizant of the fiscal imperatives. Additionally, apart from being a good negotiator, Finance Minister Omar Davies is also well respected by the trade unions. This, combined with the need for public sector downsizing (which Davies can use as a bargaining chip), could lead to reasonable wage agreements. However, even if this outcome materializes, the sluggishness in revenues combined with the anticipated surge in capital spending for the next election will put severe pressure on fiscal policy. The actual extent of fiscal indiscipline will depend on how desperate the incumbent wants the next election. (Note: The governing People's National Party (PNP) will hold an internal election on February 25 to choose the successor to Prime Minister P.J. Patterson, who has announced his intention to step down by the end of March. Patterson's successor

will then contest the next General Election with the Opposition Jamaica Labor Party no later than October 2007. End note.) This could have serious implications, as the capital market will be paying close attention to the fiscal numbers and will punish the country if the GOJ fails to pursue fiscal discipline. End comment.

JOHNSON